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C O N F I D E N T I A L SECTION 01 OF 02 RIGA 000075

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TREASURY FOR ERIC MEYER, JEFF BAKER AND DAVID WRIGHT

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SUBJECT: LATVIA LOSES TIME IN IMPLEMENTING REFORMS

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[1](#)B. RIGA 50

Classified By: Charge d'Affaires a.i. Bruce Rogers, for Reasons 1.4 (b) and (d)

[1](#)1. (C/NF) Summary: A month after agreeing in principal on a package of IMF, EU and international financial assistance, the Latvian government just recently adopted implementation plans for required economic and governmental restructuring. The Prime Minister's economic adviser says that he is astonished at how little was accomplished in the last month on planning how to spend assistance funds, and that the PM has been angered at the slow pace of action by the ministries. The PM's adviser and other experts believe that oversight by Latvia's donors will force it to eventually complete required structural changes, but the manner in which changes are being planned and implemented opens doubts about the quality of the government's overhaul. Delays cannot be blamed solely on Latvia's current political instability, but the political distractions are certainly not helping the government focus on the economic tasks at hand. End summary.

[1](#)2. (C/NF) Andris Vilks, Head Economist at SEB Bank and the PM's informal economics advisor, told us that he was out of the country for much of January, and upon his return in early February was shocked to see how little has been accomplished on the economic front. Terms of Latvia's agreements for international financial assistance required significant fiscal tightening by the government, public administration and civil service reforms, and the restructuring of government health and educational programs. In the December 2008 negotiations on the assistance, the government quickly developed goals for an Economic Stabilization Program to address donor requirements (namely, provisions included in the IMF Letter of Intent and the draft MOU with the European Commission), but final agreement on the MOU with the European Commission was not reached until January 28. Only on February 3 did the Cabinet pass an implementation plan for the Economic Stabilization Program. The implementation plan assigns responsibility among the ministries for specific restructuring tasks. Vilks noted that staff members in the ministries have been slow in giving needed feedback to the Cabinet to develop the implementation plan. He added that he could not tell if the delays were caused by "laziness or incompetence of individuals" or if the political turmoil of the last weeks (reftels) has distracted Ministers and top officials from getting things moving.

[1](#)3. (C/NF) Vilks was specifically critical of the Economics Ministry, which he said "hasn't come up with anything" on developing plans on how assistance funds could be used to help Latvian businesses and banks or to invest in long-term productivity. With the implementation plan taskings, the Economics Ministry is now required to come up with various loan and credit guarantee programs for businesses by March 30, and develop export facilitation and entrepreneurship

assistance plans by July 15. He said the Finance Ministry appears to be "hyper-active", churning out reports but with no clear direction. Their key task in the implementation plan is to develop by March 1 a strategy to sell the government's recently-acquired majority interest in Parex Bank as quickly as possible. Vilks said he planned to meet with both ministries in the coming days to assess their performance and plans. He noted that he was particularly concerned that in attempting to assist Latvian banks, those ministries may develop provisions that punish Swedish banks (such as Vilks' bank, SEB, and Swedbank) on the grounds that they are engaging in unfair competition in Latvia.

¶4. (C/NF) On the key provisions that Latvia reform its education and health care sectors, both the Health Ministry and the Education Ministry have until March 31 to develop structural reform plans. The Cabinet has directed that those plans consider World Bank recommendations, and reportedly will focus on discontinuing services in some rural areas and consolidating schools and health facilities to larger communities, which of course will be unpopular with rural residents. Press reports that initial proposals in the Health Ministry include the closing of 15 percent (13 of 86) of rural hospitals.

¶5. (C/NF) Other contacts at the Finance Ministry, Bank of Latvia, private banks and academia agreed that the economic provisions and governmental restructuring required by the assistance package would eventually be put in place, if nothing else than because donors are watching Latvia's progress closely. Both the Bank of Latvia and the Finance Ministry noted that two officials from the IMF have been

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working in the offices of the State Treasury throughout January to monitor activities. Vilks agreed that measures meeting the requirements will be implemented, but was dismayed at how little focus has been given on how to best spend the international funds, especially in relation to the private sector. President Zatlers and business groups have also complained that little information has been provided on how the international assistance will be used to help private companies or stimulate the economy.

¶6. (C/NF) Comment: As time passes, and Latvia's economic situation rapidly deteriorates, social tensions and anger at the government are building, and each week without a clear path to recovery only adds to public discontent. After quick statements of general goals, such as making government more efficient by cutting salaries and expenses, only now are key restructuring taskings and deadlines going out to the ministries. When asked about the future of key programs or how restructuring will affect Latvia's priorities and commitments, ministries continue to reply that it is too early to know and plans are just now underway. We can't say that the inaction in January will necessarily make the end-product of reform worse, but with the scale and complexity of the restructuring needed, the delays in January may turn out to be crucial time lost in developing a quality plan. The perception of government instability is wide-spread and may continue to be a distraction not only for the Cabinet and ministries, but also for investors and businesses waiting to determine if Latvia is headed out of the woods.
ROGERS